IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: California Power Exchange Corporation,	)	No. 01-70031
Petitioner.	)	

SUPPLEMENTAL BRIEF OF THE FEDERAL ENERGY REGULATORY COMMISSION

Pursuant to this Court's January 11, 2001 Order, the Federal Energy Regulatory Commission ("FERC" or "Commission") submits its supplemental brief on the issues raised by the Court regarding *San Diego Gas & Electric Co.*, 93 FERC ¶ 61,294 (2000)("December 15 Order")(Appendix C to CalPX's Petition).[1] This brief addresses the jurisdictional question (Question 3) first, as that is dispositive, before turning to the other two questions.

In summary, the Commission submits that this Court lacks jurisdiction under 16 U.S.C. § 825*l* to review the December 15 Order in the absence of a FERC order on rehearing. Even if CalPX had made the showing necessary to allow consideration of its mandamus petition (which it has not), the Court could not consider the merits of the December 15 Order.

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[1] The December 15 Order must be read in conjunction with *San Diego Gas & Electric Co.*, 93 FERC ¶ 61,121 (November 1, 2000)("November 1 Order"), attached as Appendix A to CalPX's Petition.

When the November 1 and December 15 Orders are viewed in their entirety, as they must be, it is clear that the Commission complied with both requirements of § 206(a) of the Federal Power Act ("FPA"), 15 U.S.C. § 824*e*(a). First, it found that the market structure and rules led to unjust and unreasonable rates in certain conditions. The Commission then fixed "the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force." Finally, because of the exigencies of the California circumstances, the Commission was justified in asserting its authority to prohibit the three investor owned utilities ("IOUs") from trading in the Core market on the CalPX.

I. This Court Lacks Jurisdiction To Review The December 15 Order

Although listed as the third of the questions asked, an initial determination that this Court lacks jurisdiction to review the December 15 Order while rehearing petitions are pending would obviate the need to address the remaining questions, both of which concern the merits of the Orders. Question 3 asks whether this Court has jurisdiction "in the absence of an order granting or denying [CalPX's] application for rehearing."[2] The short, simple, and complete answer is "No."

Court review of FERC actions is governed by FPA § 313, 16 U.S.C. § 825*l*. FPA § 313(a) states that no person may seek judicial review of a FERC order "unless such

[2] CalPX's rehearing request is Appendix D to its Petition.

person shall have made application to the Commission for rehearing thereon." The requirement that a court await Commission action on rehearing applications is found, as this Court's third question notes, in FPA § 313(b), which establishes that petitions for review must be filed "within sixty days after the order of the Commission upon the application for rehearing." Further, FPA § 313(b) establishes that a court may consider on review only those objections that "have been urged before the Commission in the application for rehearing."

As the D.C. Circuit has noted, "the requirements imposed by [FPA § 313] are strict and go well beyond judicially imposed standards." *Platte River Whooping Crane Trust v. FERC*, 876 F.2d 109, 112-13 (D.C.Cir. 1989)(citations omitted). Because the requirements are set by Congress, "[n]either FERC nor this Court has authority to waive" them. *Id.* at 113 (citation omitted). Although the review provision of 5 U.S.C. § 704(c) might in some cases relieve the requirement that rehearing be sought before filing for judicial review, a party must first seek rehearing where "specifically required to do so by statute - [as, for example, in] 15 U.S.C. § 717r." *ICC v. Locomotive Engineers*, 482 U.S. 270, 285 (1987).[3] The referenced statutory provision, 15 U.S.C.

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[3] *See also Darby v. Cisneros*, 509 U.S. 137, 147 (1993)(§ 704(c) "explicitly requires exhaustion of all intra-agency appeals mandated either by statute or agency rule").

§ 717r, sets out the review requirements of the Natural Gas Act, which "are identical" to those of the FPA. *Platte River*, 876 F.2d at 113 n. 1. Thus, FPA § 313 is controlling.

CalPX sought rehearing of the December 15 Order. But even CalPX concedes that its filing does not confer jurisdiction to review the December 15 Order. CalPX Pet. 19 ("December 15 Order is not yet a 'final order' from which a petition for review by this Court would lie under Section 313 of the FPA"). This concession reflects "the general notion that an administrative order is not 'final, *for purposes of judicial review*, until outstanding petitions for reconsideration have been disposed of." *CAB v. Delta Airlines, Inc.*, 367 U.S. 316, 326 (1961)(citations omitted). Recently, the Court reiterated: "The timely filing of a motion to reconsider renders the underlying order nonfinal for purposes of judicial review. In consequence, pendency of reconsideration renders the underlying decision not yet final, and it is implicit in the tolling rule that a party who has sought rehearing cannot seek judicial review until the rehearing has concluded." *Stone v. INS*, 514 U.S. 386, 392(1995)(citations omitted).

The underlying rationale also bears a long and consistent history: "when the party elects to seek rehearing there is always a possibility that the order complained of will be modified in a way which renders judicial review unnecessary." *Outland v. CAB*, 284 F.2d 224, 227-28 (D.C.Cir. 1960); quoted with approval, *Stone*, 514 U.S. at 392; *see Public Util. Commissioner of Oregon v. BPA*, 767 F.2d 622, 629 (9th Cir.

1985)(recognizing "the general presumption in favor of postponing review until the conclusion of agency proceedings. This presumption is based on the general doctrine of ripeness, and the doctrine of exhaustion. Refusing intervention in current agency proceedings ensures against premature, possibly unnecessary, and piecemeal judicial review."). That rationale takes on greater meaning where, as here, numerous rehearing requests, espousing a variety of views, are pending.

Even if FPA § 313(a) did not require a party to file for rehearing before seeking judicial review, CalPX's filing for rehearing precludes review of the December 15 Order. *See Locomotive Engineers*, 482 U.S. at 285 ("petitions for reconsideration that are actually filed [render] the orders under reconsideration nonfinal.")(citations omitted); *see United Transp. Union v. ICC*, 871 F.2d 1114, 1117 (D.C. Cir. 1989)("a pending petition for rehearing must render the underlying agency action nonfinal (and hence unreviewable) with respect to the filing party").

Likewise, even if the Commission's failure to act immediately on CalPX's rehearing request could be considered a denial, which it cannot,[4] such a denial is a nonreviewable agency action. *See Locomotive Engineers*, 482 U.S. at 280 ("an order which merely denies rehearing . . . is not itself reviewable"); *accord Your Home*

[4] *See American Rivers v. FERC*, 170 F.3d 896, 897 (9th Cir. 1999) ("Mere inaction by the FERC cannot be transmuted by petitioners into an order rejecting their petition.").

Visiting Nurse Services, Inc. v. Shalala, 525 U.S. 449, 455 (1999); *Newman v. Apfel*, 223 F.3d 937, 943 (9th Cir. 2000). *See also Entravision Holdings LLC v. FCC*, 202 F.3d 311, 312 (D.C.Cir. 2000)("Because the Commission order denying reconsideration is unreviewable . . . we dismiss the petition for lack of jurisdiction."); *Schoenbohm v. FCC*, 204 F.3d 243, 245 (D.C.Cir. 2000)(same).

In short, "the filing of a challenge to agency action before the agency has issued its decision on reconsideration is incurably premature." *TeleStar, Inc. v. FCC*, 888 F.2d 132, 134 (D.C.Cir. 1989); *Tennessee Gas Pipeline Co. v. FERC*, 9 F.3d 980, 981 (D.C.Cir. 1993)(same). *See American Rivers*, 170 F.3d at 897 ("Because appellate jurisdiction is dependent on the issuance of an order by FERC, we lack jurisdiction of the petition."). In such circumstances, "subsequent action by the agency on a motion for reconsideration does not ripen the petition for review or secure appellate jurisdiction." *TeleStar*, 888 F.2d at 134. It follows that this Court does not have "jurisdiction to review the December 15, 2000 order in the absence of an order" on rehearing, and would not have jurisdiction to treat CalPX's Emergency Motion as a petition for review of that order, even if the Commission were subsequently to issue an order on rehearing. CalPX must file a petition for review after a Commission rehearing order issues to give this Court jurisdiction to review the merits of the December 15 Order.

This result does not change because CalPX seeks a writ of mandamus. We will not reiterate all the reasons why CalPX has failed to show a clear and indisputable right to issuance of the writ. *See generally* FERC Response 9-24 (filed January 10, 2001). Even if it were assumed that CalPX had met the required burden, that would not entitle CalPX to review of the December 15 Order. A court can only take jurisdiction in a mandamus action involving non-final agency action, "in a case of 'clear right' such as outright violation of a clear statutory provision . . . or violation of basic rights established by a *structural* flaw, and not requiring *in any way* a consideration of interrelated aspects of the merits -- which can only be done appropriately on review of a final order." *Ass'n of Nat'l Advertisers v. FTC*, 627 F.2d 1151, 1180 (D.C.Cir. 1979)(Leventhal, J., concurring)(emphasis in original).

This approach to appellate review of non-final *agency* action is consistent with the approach to appellate review of non-final *court* action. The Supreme Court has promulgated a three-pronged test to determine whether the "collateral-order exception" allows immediate review of non-final court action. "First, the order must conclusively determine the disputed question. Second, the order must resolve an important issue *completely separate from the merits of the action*. Third and finally, the order must be effectively unreviewable on appeal from a final judgment." *Gulfstream Aerospace Corp. v. Mayacamas Corp*., 485 U.S. 271, 276 (1988)(internal quotation marks and

citations omitted; emphasis added); *accord, e.g., Rosenfield v. United States*, 859 F.2d 717, 720 (9th Cir. 1988). If any of the three parts are not satisfied, an appellate court may not take jurisdiction. 485 U.S. at 276.

Because CalPX's petition requires that this Court address the merits of the December 15 Order, the collateral-order exception requirements as applied to non-final agency action is not a basis for asserting jurisdiction. In any event, no other grounds would give this Court jurisdiction to review the December 15 Order in the absence of an order on rehearing, even if it is assumed *arguendo* that CalPX has shown that it is entitled to extraordinary relief. In sum, under no circumstances would this Court have jurisdiction at this time to review the December 15 Order.

II. The Commission Fully Complied With FPA § 206(a).

A. Standard Of Review

A court's role in reviewing FERC rate orders is very limited. *Nevada Power Co. v. FPC*, 589 F.2d 1002, 1005-06 (9th Cir. 1979); *cf. Permian Basin Area Rate Cases*, 390 U.S. 747, 766 (1968). "If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. . . . [T]he Commission's order . . . is the product of expert judgment which carries a presumption of validity." *Papago Tribal Utility Authority v. FERC*, 773 F.2d 1056, 1058 (9th Cir. 1985) (quoting *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) and *Nevada*

Power, 589 F.2d at 1006). Moreover, the findings of the Commission as to the facts, if supported by substantial evidence, are conclusive. *Papago*, 773 F.2d at 1058; 16 U.S.C. § 825*l*.

B. FERC Determined The Just And Reasonable Rate [5] And Fixed The Same By Order

FPA § 206(a), 16 U.S.C. § 824e(a), provides that:

> Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charges, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed and in force, and shall fix the same by order.

After determining that the market structure and rules for wholesale sales of electric energy in California had caused, and potentially could continue to cause, unjust and unreasonable rates for short-term energy in certain conditions, the Commission ordered changes to assure that future rates would be just and reasonable.

On August 2, 2000, in response to significant price increases for energy and ancillary services, San Diego Gas & Electric Company, an IOU, filed a complaint with the Commission. *See San Diego Gas & Electric Company, et al.*, 92 FERC ¶ 61,172

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[5] The term "rate" refers to all features of and affecting a rate schedule. *See East Tennessee Natural Gas Co. v. FERC*, 863 F.2d 932, 936 n.7 (D.C. Cir. 1988).

(2000). In response, the Commission instituted formal hearing proceedings under FPA § 206 to investigate the lawfulness of the rates of public utility sellers into the ISO and CalPX markets and whether the tariffs, contracts, institutional structures and bylaws of the ISO and CalPX were adversely affecting the wholesale power markets in California and, therefore, needed to be modified. *Id.* at 61,603. Further hearings were held in abeyance pending completion of a previously-ordered Commission staff investigation into many of the issues raised in the complaint. *Id.* After completion of the staff investigation and review of the entire record, FERC's November 1 Order, at 3, determined that:

> the electric market structure and market rules for wholesale sales of electric energy in California were seriously flawed and that these structures and rules, in conjunction with an imbalance of supply and demand in California, have caused, and continue to have the potential to cause, unjust and unreasonable rates for short-term energy . . . under certain conditions.

Based on that overall determination, the Commission: proposed certain remedies; [6]

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[6] The proposed remedies: (1) eliminated the requirement that the IOUs buy and sell power through CalPX; (2) required market participants to schedule 95 percent of their transactions in the Day-Ahead markets or face a penalty charge; (3) replaced the existing CalPX and ISO stakeholder boards with independent non-stakeholder boards; (4) required the filing of generation interconnection procedures; (5) set a refund obligation for sales into the ISO and CalPX markets for the period October 2000 through December 2002; and (6) temporarily replaced the single price auction with a $150/MW breakpoint; (7) imposed certain reporting requirements for bids accepted above the $150/MW breakpoint. *Id.* at 5-6.

allowed "all interested persons to file comments on the proposed remedies and any additional information or evidence;" and, ordered a public conference to "provide interested persons the opportunity to discuss the proposed remedies before the Commission." *Id.* at 6. Hearings were held in Washington D.C. and in California.

After carefully considering all comments, the December 15 Order (at 34) reaffirmed the overall finding that, as a result of the seriously flawed electric market structure and rules for wholesale sales of electric energy in California, unjust and unreasonable rates had been, and could continue to be, charged during certain periods, unless targeted remedies were implemented. Thus, the Commission stated:

> in the interest of protecting consumers, ensuring creditworthiness of market participants, and moving the Western markets toward the kind of rules that will sustain the electric industry in the long run, we adopt and direct specific remedies within our authority under the Federal Power Act. These remedies are designed to help alleviate the extreme high prices being borne by Californians, but also to ensure that sellers continue to have incentives to sell into California and sufficient incentives to build sorely needed new generation and transmission necessary to provide reliable service in the future.

Id. at 3. The following remedies were adopted to correct the specific flaws identified.

First, because "the mandatory participation requirement . . . [was] producing rates that [were] not just and reasonable during certain periods," the Commission eliminated the requirement that the IOUs sell all their generation into and buy all their energy needs from, the CalPX. December 15 Order at 4, 24, 35-40. As the Commission

explained, that "requirement caused the over reliance on spot markets, which lies at the very heart of the California's high prices," *id.* at 24, [7] and, therefore, "eliminating any mandated reliance on the spot market represents the single most important aspect of wholesale market reform and is one of the most critical components of all the immediate market reforms necessary to correct the pricing problems in California electric markets and provide long-term protection of customers," *id.* at 35.

Eliminating the mandatory buy/sell requirement releases 40,000 MWs of the IOUs' peak load from mandatory purchase on the spot market, thus permitting the IOUs to seek bilateral long-term contracts as part of balanced portfolios that would mitigate the IOUs' cost exposure to the vagaries of the spot market. December 15 Order at 4, 24. In addition, eliminating the requirement frees approximately 25,000 MW of the IOUs' own low cost hydroelectric and nuclear generation and purchased power contracts from being bid into and repurchased at higher market clearing prices in the CalPX spot market under the mandatory buy-sell requirement. *Id.* at 4, 24-25, 39. This would immediately reduce, by about 60 percent, the IOUs' exposure to the spot market pricing for their peak period load, and almost entirely eliminate their dependence on spot market pricing for off-peak load. *Id.* at 39 and n.52.

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[7] Because the CPUC views CalPX prices for spot market purchases as presumptively prudent, the IOUs excessively rely on spot purchases to the detriment of making long-term purchases. December 15 Order at 37.

Recognizing that it could assure the justness and reasonableness of California wholesale markets prices "only by eliminating [CalPX's] exclusive mandatory exchange," but that the CPUC was unwilling to relinquish reliance on its buy/sell requirement, the Commission concluded that it [was] necessary "to take the unusual step of terminating the PX's wholesale tariffs which . . . *enable it to continue to operate as a mandatory exchange*." December 15 Order at 36 (emphasis added). [8] The Commission nonetheless delayed termination until the close of the April 30, 2001, trading day to allow IOUs sufficient time to finalize alternative arrangements and to prepare a more balanced portfolio. *Id.* The Commission justified "elimination of the [CalPX] rate schedules [as] remov[ing] the medium for favoring spot sales," and as providing "IOUs with every incentive to purchase the most cost-effective portfolio rather than to simply purchase in a PX." *Id.* at 37-38.

The grounding of this action in the mandatory buy-sell requirement was reinforced by two rulings. The Commission noted that it might be able to re-institute

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[8] The Commission is free, "within the ambit of [its] statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances." *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942). FPA § 309, 16 U.S.C. § 825h, gives the Commission flexibility to take unusual remedial action as appropriate. *See Permian Basin*, 390 U.S. at 776 (applying NGA § 16, the counterpart of FPA § 309, the Court held that "the Commission's broad responsibilities . . . demand a generous construction of its statutory authority."); *FPC v. Louisiana P. & L. Co.*, 406 U.S. 621, 642 (1972)(same).

CalPX's tariffs at a later time, depending upon the CPUC's efforts to remove impediments to greater use of forward contracts or other changed circumstances. *Id.* at 36. It also stated that the PX was free to reconstitute itself as an independent, voluntary exchange without the mandated buy-sell requirement. *Id.* at 36 and n.46.

Second, to eliminate market participants' chronic underscheduling with the ISO, which jeopardized ISO system operations, created a strong sellers' market and pushed prices higher in the most volatile spot market, the Commission required market participants to preschedule 95 percent of their load, with penalties for scheduling deviations to be disbursed among all loads scheduled accurately. December 15 Order at 5, 28-29, 40-44. As the Commission explained:

> Removal of the mandatory buy/sell requirement and elimination of chronic underscheduling will directly limit the amount of load in the most volatile spot market -- the real-time imbalance energy market. Just as importantly, we believe this reform will allow the ISO to focus on the business of running the transmission system rather than a marketplace. Even at peak times, only about 2,000 MW (*i.e.* about five percent of peak load) will now be in the real-time market, down two-thirds from the prior high of 6,000 MW. This will, therefore, substantially reduce the cost exposure to buyers who now can move 4,000 MW of load into the forward markets.

Id. at 28-29.

Third, mindful that eliminating the mandatory buy/sell requirement would move a considerable amount of load into the forward long-term markets all at once, the

Commission established, effective for one year, an advisory benchmark for pricing five-year contracts. December 15 Order at 4-5, 26–28, 37. The benchmark provides guidance for market participants to evaluate the reasonableness of long-term prices, and will be considered by the Commission in addressing any complaints regarding the justness and reasonableness of long-term prices. *Id.* at 4-5, 37.

Fourth, to assure further that prices in the ISO and CalPX spot markets are just and reasonable, the Commission directed that a technical conference be held to develop a comprehensive and systematic monitoring and mitigation program that can be in place by May 1, 2001. December 15 Order at 5, 29-31, 52-55, 58. Until that date, the Commission established an interim $150/MW breakpoint for spot market sales. On an interim basis, *all* sellers bidding at or below $150/MW will receive the market clearing price up to $150/MW, but only those sellers bidding above $150/MW will receive their actual bid price. *Id.* at 5. As a result, not all MWs will be priced at the clearing price, as is currently done under CalPX's single price auction, and high spot prices will no longer be spread to all load, providing substantial relief to buyers remaining in this market. *Id.* at 29. All accepted bids above $150 must, however, file reports to permit proper monitoring and possible refunds. *Id.* at 29, 31, 55.

Fifth, because of concerns about the independence and effectiveness of the ISO governing board, the Commission ordered that the current stakeholder governing board

be replaced by a non-stakeholder board composed of members independent of market participants. December Order at 5-6, 61-62. And finally, the Commission required the ISO and the IOUs to file generation interconnection procedures to facilitate the interconnection of new generators or upgraded, existing generators, thereby enhancing system reliability and reducing price volatility. *Id.* at 6, 64-66.

In short, termination of CalPX's rate schedules was a critical part of a comprehensive set of remedies for the serious flaws in the California market structure and rules which have caused and potentially can cause unjust and unreasonable rates for short-term energy under certain conditions. Through the ordered remedies, the Commission determined "the just and reasonable rate, charge, classification, rule, regulation, practice, or contract" to replace the flawed structure and rules, and "fix[ed] the same by order." As the total effect of the Order is not unjust and unreasonable, FERC complied with its obligations under FPA § 206(a). *Hope Natural Gas*, 320 U.S. at 602; *Papago*, 773 F.2d at 1058; *Nevada Power*, 589 F.2d at 1006.

III. FERC Has Both Authority and Justification To Prohibit The IOUs From Trading In The CalPX Core Market

This Court's January 11 Order frames the operative activity in Question 2 as "trading." By "trading," we assume the Court meant to encompass the two FERC-jurisdictional sales involved under the buy-sell requirement. One sale is the IOUs' sale of their own electric energy to the PX, and the other is the sale by the PX to the IOUs. As FERC's delegated authority is limited by the FPA to such sales for resale, our analysis addresses Question 2 in this context.

As written, Question 2 assumes that FERC prohibited IOUs from trading in CalPX's CTS market. That was never the case, as was made clear by January 8, 2001 Order (Attachment 1 to FERC Opposition to CalPX Petition), which indicates CalPX, by modifying its tariffs, is free to engage in bilateral forward contracting with any buyer or seller.[9] As IOU sales to or purchases from the CTS market are not prohibited, we recast Question 2:Whether FERC has the authority, and was justified, in prohibiting the three [IOUs] from trading in the Core market on the CalPX.

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[9] *See also California Power* Exchange, 87 FERC ¶ 61,203 at 61,778(1999) ("all PX participants that purchase or sell electricity sold through the PX would be eligible to participate in [CTS's] Block-Forward Market."): *California Power Exchange Corp.*, 93 FERC ¶ 61,199 at 61,658-60 (2000)(Attachment 6 to FERC Opp.) (noting objections to proposed tariff by PG&E and SoCalEd, both "Participants" under CTS tariff, and end of mandatory buy-sell requirement, but inviting CalPX to propose modifications to CTS tariff "to support further development of the markets that it administers").

Under California restructuring law as implemented by the CPUC, the IOUs "must bid all of their generation into the PX and must purchase through the PX all of the electric energy required to serve their utility service retail customers" for a transition period. *Pacific Gas and Electric Co.*, 77 FERC ¶ 61,204 at 61,804 (1996). As this requirement involves sales for resale by the IOUs to the PX and sales for resale by the PX to the IOUs, both sales are subject to FERC jurisdiction and require FERC approval.[10] *Id*. at 61,795 ("the [CPUC] directed the [IOUs] to work together to develop a proposal to implement the PX and to apply for this Commission's authorization to make market-based wholesales sales through the PX") (footnote omitted). All concerned recognized that both sets of sales were FERC-jurisdictional**:**

> Pursuant to section 205(c) of the FPA, 16 U.S.C. § 824*d*(c) (1994), the [IOUs] will file with the Commission the rate schedules and related contracts, rules, and protocols by which they will make wholesale sales through the services provided by the PX. The [IOUs] further state that filings also will be made for all agreements governing or related to sales made through the PX, such as the "PX-Seller Agreement" and the "PX-Buyer Agreement" that each of the [IOUs] will enter into with the PX. Once filed, these rate schedules and related contracts, rules and protocols will be subject to the exclusive jurisdiction of the Commission under sections 205 and 206 of the FPA, 16 U.S.C. §§ 824d and 824e (1994).

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[10] FPA § 201(b), 16 U.S.C. § 824(b), as pertinent here, applies federal regulation to "the sale of electric energy at wholesale in interstate commerce." A sale of electric energy at wholesale "means a sale of electric energy to any person for resale." FPA § 201(d), 16 U.S.C. § 824(d). Further, "public utility" is defined in FPA § 210(e) as "any person who owns or operates facilities subject to the jurisdiction of the Commission under this part."

Id. at 61,804 (footnote omitted). *See also id*. at 61,819 (reaffirming exclusive jurisdiction under FPA §§ 205 and 206 over all matters affecting sales for resale in interstate commerce made through the PX).

Under FPA Sections 205 and 206, the Commission's authority extends to "any rates, charges, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or [to] any rule, regulation, practice, or contract affecting such rate, charge, or classification." § 206(a); *see also*§§ 205(c), 205(d) and 205(e)(same). The CPUC's mandatory buy-sell requirement is a "rule, regulation, or practice" that affected the rates and charges of the sales for resale tariffs involved in CalPX transactions. Thus, FERC has statutory authority to address this requirement.

The Court's Question 2 also asks whether the Commission had *justification* to prohibit IOUs from trading in the Core market on the CalPX. To understand the justification for the Commission's action, it is necessary to understand the regulatory framework surrounding the mandatory buy-sell requirement. The CPUC implemented the mandatory buy-sell requirement as a means of developing a "deep, transparent, reliable *commodity spot* market." CalPX November 22 Comments (Appendix B to CalPX Petition) at 22 (citation omitted; emphasis added). This requirement resulted, in part, because of the CPUC's skepticism about "the adequacy of hindsight

reasonableness reviews," *id*., that would be involved in analyzing purchases under long-term forward contracts. Accordingly, the CPUC ruled that the mandatory spot market purchases would be considered prudent *per se*.

Predictably, the IOUs purchased virtually all their needs in the spot market. For the first couple of years after restructuring, when the California electric market could be characterized as a buyer's market, this approach was successful, with spot prices being consistently lower than the frozen retail rates.[11] Last summer the market shifted to a seller's market with spot prices for electricity being consistently (much) higher than the frozen retail rates. Although the CPUC had ruled that it would be *per se* reasonable for the IOUs to enter a minimal amount of long-term (or what CTS calls bilateral forward) contracts, that ruling made little, if any, dent on the IOUs' continued over reliance on spot market purchases. *See* December 15 Order at 36 ("Many parties complain that the [CPUC's] current prudence review standard frustrates or impedes the negotiation process for longer term supply arrangements.").

As the November 1 Order found (at 24), the IOUs' reliance on the PX spot market for virtually all the IOUs' load in a time of inadequate supply "created substantial short-term cost exposure and price spikes of such a magnitude that market

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[11] As part of restructuring, the retail rates were frozen at 10 percent below the then-existing IOU rates.

confidence became virtually nonexistent."[12] This finding led to a conclusion that the buy-sell requirement "whether in [CalPX's] spot or forward markets, is a significant factor contributing to rates that are unjust and unreasonable." *Id.* This conclusion was reiterated, December 15 Order at 24, where the Commission indicated the buy-sell requirement "caused the over reliance on spot markets, which lies at the very heart of the high prices in California."

Elimination of the buy-sell requirement "received overwhelming support from parties with a broad spectrum of interests." *Id*. at 35(citing explicit support from the California Legislature). The notable dissenter was the CPUC, which indicated that "its 'buy' requirement will remain in place until the [CPUC] removes it." *Id*.[13] The Commission recognized that as long as the CPUC "continues to require (either directly or indirectly) the IOUs to sell or purchase the bulk of their needs from the PX, volatile short-term energy prices will continue to engulf the market." *Id*. Although the

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[12] The buy-sell requirement was designed, in part, to prevent the IOUs from entering long-term contracts prior to divesting their generation assets, and thus leaving an emaciated restructured market. By the time of the November 1 Order, however, the IOUs had largely divested their thermal generation, thus mitigating continued concerns on that score. *Id*.

[13] CalPX equivocally dissented, stating it did "not share the Commission's belief that the mandatory buy-sell requirement was a significant factor to the recent high prices. Nevertheless, if the mandatory buy-sell requirement is eliminated, CalPX will adjust as necessary." CalPX Comments, *supra*, at 20.

Commission has no jurisdiction to regulate state matters properly within the CPUC domain, the implications of CPUC's continued requirement *for federal rate purposes* was clear. "Unless this restriction is removed by the [CPUC], the *wholesale markets under our jurisdiction* will continue to produce prices which are unjust and unreasonable during certain periods." *Id*. at 35-36 (emphasis added). The Commission concluded, therefore, "[i]n light of the profound distorting effect this restriction has on the wholesale markets and the financial integrity of the IOUs, we have no choice but to eliminate this restriction as of the date of this order." *Id.* at 40.

Having found that circumstances created a continuing possibility of unjust and unreasonable rates and that CPUC support was unlikely, the Commission justifiably acted promptly to remedy as much of the problem as it could through its statutory delegation. Immediate prohibition of sales for resales between the IOUs and the PX was one action taken to relieve over reliance on the spot market. December 15 Order at 39. [14] Included in such sales were the IOUs' "low cost hydro and nuclear generation and purchase power contracts." *Id*. at 38. Under mandatory buy-sell, the IOUs were required to bid that low-cost generation into the PX and repurchase it at the much higher market clearing prices. *Id*. By prohibiting IOU sales to the PX, the Commission

[14] The Commission actually took several interrelated remedial actions, summarized in December 15 Order at 4-6. In the prior section, we addressed why those integrally related actions complied with FPA § 206.

expected that IOUs could self-supply their needs at much lower prices, and thus alleviate "the spiraling costs caused by the current market." *Id*. [15] The Commission's action also meant the same generation would be sold directly to retail customers, rather than to the PX for resale. This resulted in a jurisdictional shift, with the Commission's action "effectively 'de-federaliz[ing]' this portion of the market." *Id*. This gave California more control over its destiny. [16]

In sum, prohibiting IOUs' sales to the Core market on the CalPX was justified as an immediate way to reduce excessively high costs for a substantial part of the IOUs' load.

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[15] *See id.* n.52 and accompanying text (noting lower costs could be expected on 60 percent of IOUs' peak loads and 100 percent of off-peak loads).

[16] The Commission provided an important safety valve along with its prohibition: if "the IOUs' resources exceed their load at various times, they are free to sell any surplus at wholesale, pursuant to their Commission-filed rate schedules." December 15 Order at 39. Thus, any IOU surplus could be voluntarily sold through the CalPX, or under any other wholesale rate schedule.

CONCLUSION

For the reasons stated herein and in FERC's January 10, 2001 Opposition to CalPX's Petition, CalPX's emergency motion should be denied.

Respectfully submitted,

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